Opinion of the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 456—September Term, 1971.

(Argued February 2, 1972 Decided July 17, 1972.)

Docket No. 71-1871

UNITED STATES OF AMERICA,

Appellee,

v.

ROBERT SCHWARTZ,

Appellant.

Before:

HAYS and OAKES, *Circuit Judges,*
and CLARIE, *District Judge.**

Appeal from judgment of conviction for conspiracy to violate anti-hypothecation statute, 15 U.S.C. § 78h(c), after a trial before John F. Dooling, Jr., *Judge,* in the Eastern District of New York.

Affirmed.

PAUL B. BERGMAN, Assistant United States Attorney, Brooklyn, New York (Robert A. Morse, United States Attorney for the Eastern District of New York, David G. Trager, Assistant United States Attorney, on the brief), *for Appellee.*

* United States District Judge for the District of Connecticut, sitting by designation.

ARNOLD DAVIS, New York, New York, *for Appellant.*

CLARIE, *District Judge:*

The appellant was convicted after a trial by the court of having conspired to violate § 8c of the Securities Exchange Act of 1934 (the "Act"), 15 U.S.C. § 78h (c),[1] and Rule 17 C.F.R. § 240.8c-1, which prohibit the unlawful hypothecation of securities by brokers or dealers, who transact a business through a national exchange. The trial court found that appellant had unlawfully caused Armstrong & Co., Inc., a broker-dealer, to hypothecate securities "carried for the account of" its customers, so that said securities were subjected to a lien in excess of the aggregate indebtedness of the customers on such securities. The appellant was sentenced to pay a fine of $2,500 pursuant to § 32(a) of the Act, 15 U.S.C. § 78ff, and 18 U.S.C. § 371. We affirm that conviction.

Armstrong & Co., Inc. (Armstrong) was organized in 1960 by Robert Edens and Bruce Armstrong,[2] and registered with the Securities and Exchange Commission

---

1 15 U.S.C. § 78h(c) provides in pertinent part:

"It shall be unlawful for any member of a national securities exchange, or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly—

. . . .

"(c) In contravention of such rules and regulations as the Commission shall prescribe for the protection of investors to hypothecate or arrange for the hypothecation of any securities carried for the account of any customer under circumstances . . . (3) that will permit such securities to be hypothecated, or subjected to any lien or claim of the pledgee, for a sum in excess of the aggregate indebtedness of such customers in respect of such securities."

2 In 1961, Edens bought out Bruce Armstrong's interest in Armstrong.

(SEC) as a broker-dealer. Schwartz, an attorney, who had extensive experience in the securities field, acted as counsel for Armstrong which was the underwriter on several stock issuances. It was Schwartz's participation in the underwriting of a stock issuance for Triangle Instrument Co., Inc. (Triangle), that brought about this prosecution. Appellant was more than simply the firm's legal counsel; he was intimately involved in its business activities, even extending credit by exchanging checks with the firm on occasion, so that it would have needed deposits upon which it could draw.

Armstrong signed an underwriter's agreement with Triangle in which a Regulation A stock offering became effective September 15, 1961. It provided for the sale of 150,000 shares of Triangle stock at $2 per share, with "an all or nothing" proviso that required all of said shares to be sold within a 45-day period. In the event that this were not accomplished, all funds received from the shares were to be returned to the prospective purchasers without interest, and there would be no further obligation between the underwriter and the company. However, if the shares were sold within the required period, Armstrong was to pay over $230,000 to Triangle, and $70,000 was to be turned over to the underwriter to pay it a commission of 15% ($45,000) with the remaining $25,000 being used to cover expenses for accounting and legal fees.

The trial court found that at least 30,000 shares of stock were sold to individual customers of Armstrong and cash income in excess of $40,000 had been received for these shares. In addition, at least 70,650 shares were sold to brokers, who had not yet paid for them. At the end of the 45-day period, the Triangle issue had not been completely sold. When pressed by Triangle for a closing, Armstrong scheduled November 15, 1961, as the final date. Realizing

that Armstrong did not have the $230,000 necessary to effect the closing, the appellant suggested that a loan be obtained from Sterling Factors. Principally through the efforts of defendant Schwartz, an agreement between Armstrong and Sterling was concluded for a loan of $115,000 secured by a pledge of the entire 150,000 shares of the stock with endorsements in blank. This agreement provided for repayment over a 4-week period, and for the release of the shares at the rate of $2 each. It was understood that all shares would be released, when the entire note had been paid.[3]

Either prior to or at the closing, Armstrong paid over $40,000 directly to Triangle. This sum represented moneys which individual customers of Armstrong had paid for their purchase of Triangle stock. Schwartz was fully aware before the Sterling loan had been consummated, that Armstrong had sold a very substantial number of shares of this stock to customers other than broker-dealers, and that these stock customers had paid Armstrong in full.

Notwithstanding the Sterling loan, on November 15, the closing date, Armstrong was still short approximately $30,000 of the total sum due Triangle. Only by means of a loan subsequently negotiated by an officer of Armstrong was the necessary money finally obtained and the closing effected the following day. The trial court concluded that Schwartz's action in pledging all the shares of Triangle stock to Sterling Factors exposed the customers of Armstrong, who had paid full value for their shares of Triangle stock, to the risk that they might not receive the same, if Armstrong defaulted. In such event, they would be re-

---

3 Although the agreement between Armstrong and Sterling did not so provide, at the closing appellant was asked to and did guarantee the payment of Armstrong's note to Sterling. Special Findings and General Findings, at 16 (April 26, 1971).

quired to rely upon the general credit of Armstrong for the return of their money.[4]

Appellant's Claims

Appellant challenges his conviction on several grounds: (1) that he was denied his sixth amendment right to a speedy trial; (2) that the phrase "transacts a business" is so indefinite as to render 15 U.S.C. § 78h void for vagueness; (3) that the hypothecated securities were not "carried for the account of" Armstrong customers as required for a violation of 15 U.S.C. § 78h(c); (4) that the Government failed to establish the element of intent necessary for a conviction under § 32(a) of the Act, 15 U.S.C. § 78ff(a); (5) that the indictment should have been dismissed, because of the absence of sufficient evidence before the Grand Jury, and (6) that the trial court erred in receiving into evidence certain books and records of Armstrong.

Discussion of Issues

Denial of Speedy Trial

The appellant claims that his sixth amendment right to a speedy trial was violated both by the unreasonable length of time which elapsed between the commission of the offense and indictment, and by the inordinate delay between the indictment and trial. We first consider appellant's claim of unconstitutional pre-indictment delay.

---

4 Although not relevant to the legal charge against appellant, Armstrong defaulted on the payments to Sterling. Sterling released only some 38,000 shares against payments received from Armstrong. Finally, an arrangement was effected whereby Armstrong returned 25,000 shares of unsold Triangle stock to Triangle, which then paid $35,000 to Sterling in order to get release of the remaining 112,000 shares so that they could be distributed to the purchasers who had paid for them. Findings, at 19.

The crime charged is alleged to have occurred between the dates October 10, 1961 and November 15, 1961, inclusive; however, the indictment was not handed down until November 14, 1966, one day prior to the running of the statute of limitations. 18 U.S.C. § 3282. In *United States* v. *Marion*, 404 U.S. 307 (1971), the Court held that the sixth amendment is inapplicable to "pre-accusation delays." It indicated that the statute of limitations is the primary safeguard against the bringing of stale criminal charges but explicitly left open the possibility that the demonstration of "actual prejudice" stemming from pre-accusation delay might require a dismissal under the Due Process Clause.[5] 404 U.S. at 324.

The appellant claims that he was actually prejudiced by this pre-indictment delay. He represents that during the SEC investigation into Armstrong's activities, he was assured that there were no claims of wrongdoing against him, and that he was permitted to represent Armstrong as counsel in that administrative proceeding. He explains that he was lulled into a sense of security by the overall circumstances and the inordinate delay, so that he destroyed 50 to 60 Armstrong files some 1 to 2 years after the completion of the SEC investigation. He would now ask the court to believe that the loss of these files impaired his

---

5 The Court in *Marion* indicated that the Due Process Clause would require dismissal of the indictment "if it were shown at trial that the pre-indictment delay . . . caused substantial prejudice to appellees' rights to a fair trial and that the delay was an intentional device to gain tactical advantage over the accused." 404 U.S. at 324 (footnote omitted). Although appellant in the instant case claims actual prejudice, he does not assert, and the record in no way indicates, that the Government delayed bringing the indictment in order to secure a "tactical advantage" over the accused.

The Court in *Marion* set forth no guidelines for makin gthe "delicate judgment," 404 U.S. at 325, as to when actual prejudice alone warrants the dismissal of an indictment for pre-accusation delay.

ability to properly prepare his defense against these criminal charges.

A review of the record discloses that the appellant has failed to factually establish that he has suffered any significant prejudice as a result of any delay which led to the destruction of the Armstrong files. *United States* v. *Scully*, 415 F.2d 680, 683 (2d Cir. 1969); *see also, United States* v. *Iannelli*, —— F.2d ——, (2d Cir. May 22, 1972) (slip op. 3195, 3199-3200); *United States* v. *Capaldo*, 402 F.2d 821 (2d Cir. 1968), *cert. denied*, 394 U.S. 989 (1969). There is no evidence to indicate that he was unable to credibly reconstruct the hypothecation transaction. *United States* v. *Feinberg*, 383 F.2d 60, 65 (2d Cir. 1967), *cert. denied*, 389 U.S. 1044 (1968). It would appear that under the circumstances, the appellant should have preserved the files for the benefit of his client, Armstrong, with whom he was so intimately associated.

The evidentiary record indicates that appellant has also failed to demonstrate, that any memory lapses attributable to the time delay between the offense and the trial made "suspect" the "reliability of the proceedings for the purpose of determining guilt." *United States* v. *Feinberg*, *supra*, 383 F.2d at 66. Thus, he has not demonstrated material pre-indictment prejudice sufficient to warrant dismissal under the Due Process Clause of the fifth amendment.

An alternative aspect of the appellant's claim of unreasonable delay refers to the post-indictment period. The trial did not commence until March, 1971, approximately 4½ years after the filing of the indictment.[6] The court has set out 4 factors, to consider when determining questions relating to a speedy trial; (1) length of the delay;

---

6 The Second Circuit Rules Regarding Prompt Disposition of Criminal Cases went into effect June 5, 1971, after the commencement of the trial in this case.

(2) reason for the delay; (3) prejudice to the defendant; and (4) waiver by the defendant. *United States ex rel. Solomon* v. *Mancusi*, 412 F.2d 88, 90 (2d Cir. 1969), *cert. denied*, 396 U.S. 936 (1969), *followed in, e.g., United States* v. *Fitzpatrick*, 437 F.2d 19, 26-27 (2d Cir. 1970), and *United States* v. *Stein*, 456 F.2d 844, 847-848 (2d Cir.), *cert. denied*, 40 U.S.L.W. 3611 (U.S. June 26, 1972).

The Supreme Court has recently held in *Barker* v. *Wingo*, 40 U.S.L.W. 4840 (U.S. June 22, 1972), that all of these factors should be weighed with each other and considered together with other relevant circumstances, recognizing that this places upon the courts a duty to "engage in a difficult and sensitive balancing process." *Id.* at 4846.

The record does not disclose the reasons for the post-indictment delay. However, it is significant to note that the appellant and 8 other defendants were indicted on 18 counts. The first 17 counts involved all of the defendants, while the final count named only appellant and Edens, the president of Armstrong. Both the Government and the defendants focused their initial procedural efforts largely upon the first 17 counts. Count 18 was severed from the other counts of the indictment in June, 1967.

Appellant filed motions for multiple relief in February, 1968. He sought dismissal of the indictment on the ground that his fifth amendment rights were invaded, when the Assistant United States Attorney interviewed him seemingly as a cooperative witness, but without advising him that he was a prospective defendant. He also requested at that time a bill of particulars, and the right to inspect or an *in-camera* inspection by the court of the grand jury minutes. All of these matters were acted upon by the court. The case then lay dormant during 1969 and in February, 1970, the trial was scheduled on the first 17 counts for August, 1970. Changes of plea were subsequently en-

tered by 7 of the defendants on the 17-count phase of the indictment, and none of those counts ultimately went to trial.

In June, 1970, the appellant first moved to dismiss count 18 for delay in prosecution and for factual insufficiency. The court denied both motions; the second in a lengthy opinion on October 2, 1970. The trial commenced in March, 1971. Just prior thereto, in January, 1971, co-defendant Edens entered a plea of nolo contendre on the 18th count.

While it could not be said that the Government promptly pressed the prosecution of count 18, we cannot attribute controlling significance to the Government's lack of vigilance for two reasons: (1) there has been no claim, nor does the record indicate, that any governmental delay here was a "purposeful or oppressive" violation of appellant's sixth amendment rights. *United States ex rel. Solomon* v. *Mancusi*, *supra*, 412 F.2d at 91, *quoting Pollard* v. *United States*, 352 U.S. 354, 361-362 (1957). *See also*, *United States* v. *Stein*, *supra*, at 848; and (2) we are not persuaded that the petitioner's claims of prejudice have any merit.

In addition to the previously discussed issues relating to the claimed destruction of records and alleged impairment of memory, appellant's principal claims of prejudice center around the unavailability at trial of a former SEC official.[7] Appellant represents that he had solicited and received from him an informal expression of opinion approving the proposed transaction. He claims that had the SEC official been available at the trial, he would have confirmed the appellant's claim that he had acted in good faith.

The trial court found, however, that the evidence did not establish that the appellant had discussed this trans-

---

7 Well-advanced in years and seriously ill at the time of trial, the SEC official was unable to travel from his home in New Jersey to New York City to testify.

action with a representative of the New York office of the SEC and received from him an opinion shown to have been based upon a complete disclosure of the relevant facts. It also concluded that even if such an opinion had been expressed under informal circumstances, the defendant would not have been justified in relying upon it. That court expressly found "that the defendant Schwartz did not proceed in good faith reliance upon a belief derived from an interview with a responsible representative of the SEC, that the transaction with Sterling Factors was in conformity with and not violative of the hypothecation regulations." [8] Even were this court to find to the contrary, and conclude that such a showing would vitiate the mental state requisite for a violation of this statute, the appellant's claim of prejudice must fail, since he did not see fit to timely avail himself of the deposition procedures afforded under Rule 15, Fed. R. Civ. P., so as to make available at trial, the testimony which he now claims could have been relevant.

The failure of a defendant to request a prompt trial may constitute a waiver of that right, even though waiver is only one relevant factor to be weighed with others in determining whether there has been a violation of sixth amendment rights.

> "It has long been the rule of this Circuit that the failure to demand a speedy trial constitutes a waiver of that right, (citing *United States* v. *Lustman*, 258 F.2d 475, 478 (2d Cir. 1958), *cert. denied*, 358 U.S. 880 (1958); *United States* v. *Smalls*, 438 F.2d 711, 714 (2d Cir. 1971), *cert. denied*, 403 U.S. 933 (1971)); *cf. Dickey* v. *Florida*, 398 U.S. 30, 36 (1970). While Rule 8 of this court, concerning the prompt disposition of criminal cases, dispenses with the need for

8 Findings, at 20-21.

demand, waiver may still be considered as a relevant factor in deciding whether or not the constitutional right to a speedy trial has been violated." *United States* v. *Singleton*, —— F.2d —— (2d Cir. May 12, 1972) (slip op. 2987, at 2990-2991), *See also Barker* v. *Wingo*, *supra*.

Here the appellant moved to dismiss the indictment for delay in prosecution on June 15, 1970. Considering that motion as a demand for a speedy trial, we conclude that the 9-month delay between that demand and the commencement of the trial in March, 1971, is not of sixth amendment proportions, when we consider that a sustantial part of this 9-month period was taken up with the trial court's consideration of a motion by appellant to dismiss count 18 for factual insufficiency. *Cf. United States ex rel. Schaedel* v. *Follette*, 447 F.2d 1297, 1301 (2d Cir. 1971).

Using the prescribed balancing test, *Barker* v. *Wingo*, *supra*, while the length of the delay was substantial here, as in *United States* v. *Stein*, *supra*, the case involved complex securities transactions and extensive pretrial motions and procedures; there has been no substantial showing of prejudice; there were no "purposeful or oppressive" delays on the part of the Government; and there was only a rather belated effort on the part of the defendant to bring the case to trial. We conclude that the defendant was not denied his sixth amendment rights.

Vagueness

The appellant's next contention is that § 8(c) of the Act is void for vagueness. He challenges primarily the application to his case of the jurisdictional phrase, "any broker or dealer who *transacts a business* in securities through the medium of any such member (of a national securities

exchange)." We conclude that the trial court's construction of this term was proper, and that the phrase is sufficiently clear to satisfy due process requirements.

Appellant points out that that phrase, "transacts a business," was previously construed in a 1939 Federal Reserve Board decision, so as to bring within the purview of Regulation T any broker-dealer who conducted approximately 10% of its total securities business through the medium of members of a national securities exchange.[9] He argues that any subsequent construction of this phrase should limit the reach of the statute to those broker-dealers showing at least this 10% minimal factor. Since Armstrong's gross business in this area amounted to only 1% or less of its total transactions, appellant contends that § 8(c) of the Act is not applicable to him.

The trial court found that although Armstrong dealt primarily with over-the-counter securities, it regularly handled customers' transactions in securities listed on the major stock exchanges and transacted a modest business in such securities through members of the national securities exchanges. Although the business was only 1% or less, it was nevertheless a valued and material part of its overall business activities.

The trial court correctly concluded that Congress intended § 8(c) to apply to any broker or dealer, who transacted more than a trivial or *de minimis* business in securities through the medium of members of national securities exchanges. The very purpose of this Act was to provide remedial legislation, and it should be construed broadly,

---

9 25 Fed. Res. Bul. 961 (1939). Regulation T, 12 C.F.R. §§ 220.1 et seq., promulgated by the Federal Reserve Board pursuant to § 7(c) of the Act, 15 U.S.C. § 78g(c), deals with credit extensions by brokers and dealers. The phrase, "who transacts a business in securities through the medium of any such member (of a national securities exchange)" was removed from § 7(c) in a 1968 amendment.

Tcherepnin v. *Knight*, 389 U.S. 332, 336 (1967), in order to effect the congressional purpose of "insur(ing) the maintenance of fair and honest markets." 15 U.S.C. § 78b. *Cf. United States* v. *Re*, 336 F.2d 306, 316 (2d Cir. 1964), *cert. denied*, 379 U.S. 904 (1964).

For the appellant's vagueness claim to be persuasive, it would have to meet the standards which this Court recently set out for use in evaluating a claim of statutory vagueness:

> "The applicable test is whether the language conveys 'sufficiently definite warning as to the proscribed conduct when measured by common understanding and practices.' *United States* v. *Petrillo*, 332 U.S. 1, 8 (1947). *See United States* v. *16,179 Molso Italian .22 Caliber Winless Derringer Convertible Starter Guns*, 443 F.2d 463, 466 (2d Cir. 1971), (*cert. denied*, 404 U.S. 983 (1971)). A statute violates due process if 'men of common intelligence must necessarily guess at its meaning and differ as to its application.' *Connally* v. *General Construction Co.*, 269 U.S. 385, 391 (1926). Even in criminal cases, however, where the vagueness standard is most stringently applied, the statute must only present 'ascertainable standard(s) of guilt.' *Winters* v. *People of the State of New York*, 333 U.S. 507, 515 (1948). As the Supreme Court stated in *Petrillo:*
>
> 'That there may be marginal cases in which it is difficult to determine the side of the line on which a particular fact situation falls is no sufficient reason to hold the language too ambiguous to define a criminal offense. . . . The Constitution does not require impossible standards.' 332 U.S. at 7." *United States* v. *Deutsch*, 451 F.2d 98, 113-114, (2d Cir. 1971), *cert. denied* 404 U.S. 1019 (1972).

The statutory phrase challenged here provides adequate notice to men of common intelligence as to its meaning

and application. The term in question does not require that a substantial or principal part of the broker's business be conducted through members of the national securities exchanges, but only an ongoing regular portion thereof. The claim of statutory vagueness is therefore without merit.

Hypothecation of Stock

Appellant next contends that the Government has failed to prove an unlawful hypothecation within the purview of 15 U.S.C. § 78h(c). He argues that the securities here were not "carried for the account of any customer" at the time of the pledge to Sterling Factors, and that therefore no hypothecation occurred.

Section 78h(c) and Rule 8c-1 proscribe the hypothecation of "securities carried for the account of any customer," when that hypothecation subjects those securities to any lien or claim of the pledgee for a sum in excess of the aggregate indebtedness of the customers in respect to such securities. Rule 8c-1(b)(2) sets forth three separate definitions of the trade term, "securities carried for the account of any customer." [10] The trial court found that each

---

10 Rule 8c-1(b)(2) provides:

"(2) The term 'securities carried for the account of any customer' shall be deemed to mean:

"(i) Securities received by or on behalf of such member, broker or dealer for the account of any customer;

"(ii) Securities sold and appropriated by such member, broker or dealer to a customer, except that if such securities were subject to a lien when appropriated to a customer they shall not be deemed to be 'securities carried for the account of any customer' pending their release from such lien as promptly as practicable;

"(iii) Securities sold, but not appropriated, by such member, broker or dealer to a customer who has made any payment therefor, to the extent that such member, broker or dealer owns and has received delivery of securities of like kind, except that if

of these definitions was satisfied. Since we find that the transaction at bar satisfies at least the first definition, we need not consider the others.

Said Rule 8c-1(b)(2) provides:

> "The term 'securities carried for the account of any customer' shall be deemed to mean:
>
> "(i) Securities received by or on behalf of such member, broker or dealer for the account of any customer."

The thrust of the appellant's claims on this issue, is that these securities were not carried for the account of any customer, because at the time Triangle stock was pledged to Sterling, some of the stock issue was still unsold and some had not yet been paid for. He argues that if the securities were being carried by Armstrong for its customers at the time of the hypothecation, then Armstrong was purchasing these securities not yet sold to and paid for by the public, for its own account subject to the lien of Sterling. Appellant contends that under Regulation A, 17 C.F.R. §§ 230, 251 et seq.,[11] Armstrong was barred from taking down stock in its own name, until the entire stock issue was fully sold and paid for, by the funds of the public subscribers. In appellant's view, Armstrong cannot be said to have carried Triangle securities for the account of

---

such securities were subject to a lien when such payments were made they shall not be deemed to be 'securities carried for the account of any customer' pending their release from such lien as promptly as practicable." 17 C.F.R. § 240.8c-1(b)(2).

11 Regulation A, issued pursuant to 15 U.S.C. §§ 77c(b), exempts certain securities offerings from the registration requirements of the Securities Act of 1933.

its customers at the time of the hypothecation; otherwise, Armstrong would have been in violation of Regulation A. Such an argument is fallacious, for even if the transaction in question did violate Regulation A, appellant cannot negatively explain away and attempt to justify the hypothecation violation, by pointing also to a Regulation A violation. The hypothecation here subjected the customers, who had paid for their stock, to precisely the kind of risk from which the statute and rule were intended to protect them. These securities which had been sold and paid for were in fact carried for the accounts of customers at the time of the pledge, within the meaning of the statute and rule.

Appellant also claims that Armstrong never "received" the shares, because Armstrong had transferred its interest in the Triangle shares to its pledgee, Sterling, on the day prior to issuance of the stock, when Armstrong delivered to Sterling stock powers signed in blank. The trial court concluded that "(i)f subsection (b)(2)(i) is in simplicity interpreted to include any security bought and paid for by a customer, that is so far 'received' by the broker that he is able to pledge it, then there is no problem in directly applying the statute" and rule to the hypothecation here.[12] Such a construction comports with the expressed Congressional intent to safeguard investors from irresponsible

---

12 Ruling on Motion to Dismiss the Indictment, at 10 (October 2, 1970).

Judge Dooling also pointed out that:

> "Armstrong's possession and control of the 150,000 shares was momentary and essentially notional or 'constructive' receipt and possession of the stock incident to and implicit in the Meadowbrook (the transfer agent)-Triangle delivery at Armstrong's behest of the certificates and the 'stock powers' to Sterling in satisfaction of Armstrong's obligation to do so created by Sterling's delivery of the $115,000 to Meadowbrook-Triangle." *Id.* at 7.

brokerage practices.[13] *Cf. SEC* v. *Joiner Corp.*, 320 U.S. 344, 350-351 (1943).[14]

Willfulness

Appellant's next contention is that his conviction cannot stand, because the Government's proof failed to establish *mens rea*—a specific criminal intent to violate the statute and regulation. The trial court found that although appellant knew of the existence and terms of the anti-hypothecation regulation, the Government failed to prove that the appellant believed or knew that the transaction with Sterling was a violation of the law and regulation.[15] Section 32(a) of the Act, 15 U.S.C. § 78ff(a), provides in part:

---

13 The Senate Report on the Securities Exchange Act of 1934 pointed out that:

> "Severe financial losses have been sustained by investors from time to time in cases where a broker pledged his customers' securities for loans in excess of the aggregate indebtedness due him in respect of such securities, or pledged them along with his own securities to finance his private speculative commitments." Sen. Rep. No. 792, 73rd Cong., 2d Sess. (1934), at 11.

The House Report on the Act stated that,

> "A broker is forbidden . . . to pledge customers' securities . . . under circumstances that will subject customers' securities to a lien in excess of the aggregate indebtedness of the customers. This means that a broker cannot risk the securities of his customers to finance his own speculative operations." H.R. Rep. No. 1383, 73rd Cong., 2d Sess. (1934), at 20.

14 ". . . courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." (footnote omitted) 320 U.S. at 350-351.

15 As already noted, however, the trial court specifically found that appellant did not act in good faith reliance upon a belief derived from an interview with a representative of the SEC that the hypothecation transaction was not violative of the statute and regulation.

> "Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter . . . shall upon conviction be fined not more than $10,000 or imprisoned not more than two years, or both . . . but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation."

Appellant argues that the statutory requirement of willfullness necessitates proof not only of an intent to commit the act which constitutes the violation, but also a "specific intent to do that which the law forbids." *United States* v. *Krosky*, 418 F.2d 65, 67 (6th Cir. 1969). The final clause of § 32(a), however, makes it clear that the statute contemplates a "willful" violation by one who has no knowledge[16] of the violated rule or regulation. Since specific intent to violate the law presupposes knowledge of the law, it follows that such a specific intent is not necessary to sustain a conviction under § 32(a) for a violation of § 8(c) and the regulation adopted pursuant thereto.

The district court spelled out specifically what it found to be the appellant's state of mind, at the time he committed the offense and found him to be criminally culpable.

> "Defendant's guilt is placed on his knowledge of the rule, his conscious and intentional participation in acts which constituted a violation of it, and his necessary perception that what was done subjected the customers who had paid for their stock to precisely the risk

---

16 "Proof of 'no knowledge' of the rule can only mean proof of an ignorance of the substance of the rule, proof that they did not know that their conduct was contrary to law." *United States* v. *Lilley*, 291 F.Supp. 989, 993 (S.D. Tex. 1968).

which the rule intended to protect them from having imposed upon them. That defendant may have believed or hoped that the regulation did not proscribe the precise kind of closing transaction set up with Sterling Factors, did not acquit him of guilt . . . . The transaction was nevertheless, as the *Atwater* case (*People* v. *Atwater*, 229 N.Y. 303, 128 N.E. 196 (1920)) suggests, in fact a violation of a regulation known to exist, and a reprehensible act within its own dimensions independently of the regulation." [17]

Proof of a specific intent to violate the law is not necessary to uphold a conviction under § 32(a) of the Act, provided that satisfactory proof is established that the defendant intended to commit the act prohibited. This conclusion is in harmony with the rationale in several decisions, which have considered the kind of intent necessary to sustain a criminal conviction or the imposition of a civil penalty for that class of violations designated as "public welfare offenses." *Morissette* v. *United States*, 342 U.S. 246, 255 (1952). *See In the Matter of Cortlandt Investing Corp.*, Sec. Ex. Act Rel. 7682 (1965) at 5-6 (SEC upheld expulsion of a firm by the National Association of Securities Dealers in part for two violations of antihypothecation rule, 17 C.F.R. 240. 15c2-1, although it was found that the violations were inadvertent. The Commission concluded that while the lack of an intention to violate the rule might have some bearing on the penalty, it was not relevant to the question of whether a violation had occurred. Under all the circumstances, however, the Commission modified the expulsion to a 30-day suspension. Noted at 5 Loss, Securities Regulation 3202-3203 (Supple-

---

17 Ruling on Motion for Judgment of Acquittal and for a New Trial, at 8 (May 14, 1971).

ment to Second Ed. (1969)); *United States* v. *Sussman*, 37 F.Supp. 294, 296 (E.D. Pa. 1941); *cf. United States* v. *International Minerals & Chemical Corp.*, 402 U.S. 558 (1971); *United States* v. *Freed*, 401 U.S. 601, 607-610 (1971); *Morissette* v. *United States*, *supra*, 342 U.S. at 252-262; *United States* v. *Dotterweich*, 320 U.S. 277, 280-281 (1943); *United States* v. *Ruisi*, —— F.2d ——, —— (2d Cir. May 22, 1972) (slip op. 3141, at 3146-3147); *Tager* v. *Securities and Exchange Commission*, 344 F.2d 5, 8 (2d Cir. 1965); *United States* v. *Custer Channel Wing Corp.*, 376 F.2d 675, 680-682 (4th Cir. 1967), *cert. denied*, 389 U.S. 850 (1967); *Hughes* v. *Securities and Exchange Commission*, 174 F.2d 969, 976-977 (D.C. Cir. 1949). *See generally* 2 Loss, Securities Regulation 1307-1312 (Second Ed. 1961), supplemented by 5 Loss, Securities Regulation 3366-3374 (1969); 3 Loss, Securities Regulation 1984-1987 (Second Ed. 1961), supplemented by 6 Loss, Securities Regulation 4123-4127 (1969) (After reviewing the cases, Professor Loss concluded that "it seems reasonably well settled that 'willfully' in the SEC statutes does not have any 'bad purpose' connotation (beyond whatever bad faith concept is inherent in the fraud provisions as distinct from the registration provisions and the like).") *But see*, Herlands, Criminal Law Aspects of the Securities Exchange Act of 1934, 21 Va. L. Rev. 139, 142-150 (1935). *But cf. United States* v. *Murdock*, 290 U.S. 389, 394 (1933); *United States* v. *Van de Carr*, —— F.Supp. —— (C.D. Cal. May 19, 1972), 40 U.S.L.W. 2812.

Because appellant was not charged with a substantive violation of the anti-hypothecation statute, but rather with conspiracy, under 18 U.S.C. § 371, to cause Armstrong to violate that statute, it is necessary to consider whether this conspiracy charge raises the level of requisite criminal intent beyond that we have held necessary to sustain

a substantive conviction under § 78h(c) and § 78ff of the Act. *United States* v. *Freed, supra*, 401 U.S. at 609 n. 14. In *Ingram* v. *United States*, 360 U.S. 672, 678 (1959), the Supreme Court held that,

> "(C)onspiracy to commit a particular substantive offense cannot exist without *at least* the degree of criminal intent necessary for the substantive offense itself." (footnote omitted) (emphasis in original).

The cases applying this principle largely deal with the situation in which a defendant was convicted of conspiracy on a showing of criminal intent less than that necessary to sustain a violation of the substantive offense. *See, e.g., United States* v. *Hysohion*, 448 F.2d 343, 347 (2d Cir. 1971); *United States* v. *Gallishaw*, 428 F.2d 760, 763 (2d Cir. 1970); *United States* v. *Bufalino*, 285 F.2d 408, 415-416 (2d Cir. 1960); *United States* v. *Ausmeier*, 152 F. 2d 349, 356 (2d Cir. 1945). We conclude that, under the facts of this case, a conspiracy conviction will be sustained upon the same showing of criminal intent necessary to make out a violation of the substantive offense. *Cf. United States* v. *Mack*, 112 F.2d 290, 292 (2d Cir. 1940). The evidence clearly indicates that appellant and Edens agreed to and did perform those acts which legally constituted a violation of the anti-hypothecation statute and regulation.

Sufficiency of the Indictment

We next deal with the appellant's claim that his conviction violates the fifth amendment because the evidence presented to the grand jury was insufficient to justify his indictment. The trial court denied appellant's motion to dismiss the indictment, and held that

> "The precise language of Mr. Justice Black in *Costello* v. *United States*, 350 U.S. 359 at 363, makes the bare vote of the Grand Jury enough. Here there was that and nothing more. There was no evidence 'sufficient' by any standard to support the charge. Nevertheless, the motion must be denied."

Appellant contends that the several decisions of this Circuit which somewhat modify *Costello* with respect to indictments based largely and unjustifiably upon hearsay, *see, e.g., United States* v. *Arcuri*, 405 F.2d 691 (2d Cir. 1968), *cert. denied*, 395 U.S. 913 (1969), require reversal here. There is no merit to this contention. This court has held that

> "A defendant has no right to have an indictment dismissed merely because incompetent or inadequate evidence was presented to the Grand Jury. *Lawn* v. *United States*, 355 U.S. 339, 78 S.Ct. 311, 2 L.Ed. 2d 321 (1958); *Costello* v. *United States*, 350 U.S. 359, 76 S.Ct. 406, 100 L.Ed. 397 (1956). But a motion to dismiss or quash an indictment because of the absence or incompetency of evidence before the Grand Jury is addressed to the discretion of the trial court, and the decision to grant or deny the motion will not be reversed unless there has been an abuse of that discretion. (citations omitted) As long as there is some competent evidence to sustain the charge issued by the Grand Jury, an indictment should not be dismissed. *Coppedge* v. *United States*, 311 F.2d 128, 132 (D.C. Cir. 1962), (*cert. denied*, 373 U.S. 946 (1963))." *United States* v. *Tane*, 329 F.2d 848, 853-854 (2d Cir. 1964).

See also, United States v. *Ramsey*, 315 F.2d 199 (2d Cir. 1963) (*per curiam*), *cert. denied* 375 U.S. 883 (1963). We conclude that there was "some competent evidence" to sup-

port this indictment and that the trial judge did not abuse his discretion in declining to dismiss it.[18] Appellant does not claim that the Grand Jury was biased or prejudiced against him. The "integrity of the judicial process" is not seriously threatened by this indictment. *United States v. Leibowitz*, 420 F.2d 39, 42 (2d Cir. 1969).

Business Records

We finally consider appellant's argument that the trial court erred in admitting the blotters and ledgers of Armstrong into evidence pursuant to the Federal Business Records Act, 28 U.S.C. § 1732. The trial court found that these records had been impeached for accuracy and completeness, but that they had been made in the regular course of Armstrong's business, and that it was the regular course of the business of Armstrong to keep such records. We find no error. *See United States v. Re*, 336 F.2d 306, 311-314 (2d Cir. 1964), *cert. denied*, 379 U.S. 904 (1964). Further, appellant has not pointed to any specific instance where the district court relied upon an unclear entry to his prejudice. *Cf. United States v. Schubert*, 362 F.2d 369, 371-372 (2d Cir. 1966), *cert. denied*, 385 U.S. 919 (1966).

We have considered appellant's other contentions and find them without merit. The judgment of conviction is affirmed.

---

18 The trial judge noted that since appellant delayed until 1970 in making the motion to dismiss the indictment because of the insufficiency of the evidence presented to the Grand Jury, discretion called for denial of the motion. Ruling on Motion to Reconsider, at 5. (August 12, 1970) (Dooling, *J.*).

The evidence presented to the Grand Jury included the hypothecation agreement between Armstrong and Sterling; testimony as to appellant's guaranteeing Armstrong's note to Sterling; and the 1962 SEC Report on Armstrong, which in part sketched the hypothecation transaction between Armstrong and Sterling. SEC Report, at 52-62.

Judgment of Affirmance

UNITED STATES COURT OF APPEALS

For the Second Circuit

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the seventeenth day of July one thousand nine hundred and seventy-two.

Present:

Hon. Paul R. Hays, Hon. James L. Oakes,
Circuit Judges,

Hon. T. Emmet Clarie,
District Judge.

United States of America,
Plaintiff-Appellee,

v.

Benjamin Saporta, Howard Cohen, Eugene Preiman, Herbert Patlis, Albert Wasserman, Stanley Weiss, Martin Lasher, Robert Schwartz and Robert B. Edens,
Defendants,

Robert Schwartz,
Defendant-Appellant.

Appeal from the United States District Court for the Eastern District of New York.

Judgment of Affirmance

This cause came on to be heard on the transcript of record from the United States District Court for the Eastern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed.

A. Daniel Fusaro,
Clerk

Special Findings and General Findings of District Court

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF NEW YORK

66 CR 425

UNITED STATES OF AMERICA,

—against—

ROBERT SCHWARTZ,

Defendant.

Appearances:

PETER R. SCHLAM, Esq. (EDWARD R. NEAHER, Esq., United States Attorney, and THOMAS P. PUCCIO, Esq., Of Counsel), for the Government.

ROBERT SCHWARTZ, Esq., *Pro Se;* LOUIS J. PETTA, Esq., accompanied Mr. Schwartz and advised him at times during the trial.

DOOLING, *D.J.*

Armstrong & Co., Inc. was organized in 1960 by Robert B. Edens and his brother-in-law, Bruce Armstrong, and was originally intended to be operated by Bruce Armstrong. Defendant Robert Schwartz, who is a member of the Bar, has had extensive experience in the legal and business aspects of the securities business and in advising brokerage

and broker-dealer firms active in the securities field. When Armstrong was organized, defendant Schwartz handled the legal aspects of the registration of Armstrong & Co., Inc., under Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. § 78o(b)), and throughout the period in question he continued to act as counsel to Armstrong, particularly in the matters related to its filings under the '34 Act, including the registration of salesmen and the like; in addition defendant Schwartz acted as counsel to Armstrong as underwriter in connection with the Triangle Instrument Co., Inc., Regulation A offering of 150,000 shares of Triangle Instrument Co., Inc., common stock.

Armstrong was registered with the SEC as a Broker-Dealer from about October 1960. Its operation under Bruce Armstrong did not expand satisfactorily, and in January or early February 1961, Robert Edens bought out Bruce Armstrong's interest in Armstrong for a nominal amount. At that time the firm had neither employees nor underwritings. Edens at once expanded the firm's office space and hired salesmen. From the beginning Armstrong handled for its customers transactions in securities listed on the major stock exchanges, and, in that connection, transacted a modest business in such securities through members of the national securities exchanges. That business may have amounted to one per cent or less of Armstrong's total transactions, but there is no indication that it was not a valued and necessary part of its business activities. But the principal objective of Edens was to expand into the over-the-counter business and the area of the modest Regulation A issues. Defendant Schwartz was then very active in securities work and, particularly, in offerings of new issues of securities. His law office was handling about one new issue a week, and, since issues took a considerable

time to bring to completion, he had as many as 30 to 40 proposed offerings in progress at any one time.

Defendant Schwartz was materially and directly helpful to Edens in Edens' effort to get Armstrong started in the securities business. When Edens indicated that he wanted to get into the new issue business, defendant Schwartz arranged for Armstrong to get a substantial position in the underwriting of three successive issues all of which were already in progress when Armstrong got into them. The issues were not unsuccessful, and Edens went on to a fourth underwriting which he undertook without any direct assistance from defendant Schwartz in obtaining the issue, although defendant Schwartz did act as counsel for Armstrong as underwriter on the issue.

The fifth issue with which Armstrong was connected was the Triangle Instrument Co., Inc., Regulation A issue, and defendant Schwartz acted as counsel for Armstrong as underwriting on the issue. Work on the issue was started as early as March 15-30, 1961, when an underwriter agreement was signed, but the offering circular did not become effective till September 15, 1961. The securities were offered starting on or about that date and continuing apparently until the end of October and possibly into November 1961. The Triangle issue, which is central to the problem presented in the present case, was followed by an issue for Precision, Inc.

In all, Armstrong during the period of its operation appears to have been engaged in as many as 7 issues; its operation expanded to the point at which it had 8 to 15 salesmen and was handling a great many transactions. Throughout this period of intense activity defendant Schwartz was in close touch with the firm and its principal Edens. He lent it the financial support of exchanging

checks with it so that it would have deposits upon which it could draw immediately. The evidence leaves no doubt that in a general way at least defendant Schwartz knew the nature and the extent of the firm's activity, materially contributed to its business, and regularly performed legal services for Armstrong and gave it legal advice in connection with its securities business. Throughout the latter part of 1961 defendant Schwartz' connection with Armstrong was very frequent and intimate.

During the spring of 1961, Martin Lasher joined the firm, became a vice president, and, directly and indirectly, became a very substantial contributor to its capital funds. While he was an active participant in the business of the firm, his role in the firm seemed to have been definitely subordinate to Edens', and Lasher's contacts with defendant Schwartz appear not to have had the extent and significance that the contacts between defendant Schwartz and Edens had throughout the latter part of the firm's life.

Apparently as the business of Armstrong expanded it became very considerably over-extended. To defendant Schwartz' knowledge the firm had, at minimum, got to a position in which it was steadily in need of cash because it was attempting to carry more securities in its portfolio than its limited capital made possible. The evidence is that defendant Schwartz specifically knew that there were at least several occasions during 1961 when Armstrong checks were returned by the bank on the grounds that Armstrong had insufficient funds to cover them, and defendant Schwartz was clearly aware that the firm's situation was one of cash stringency.

The Triangle Instrument issue was an "all or nothing" issue. That expression meant that while the underwriter had undertaken to use its best efforts to offer and sell

150,000 shares of Triangle stock at $2 a share and undertook to hold funds received on account of such shares until the entire issue had been sold and paid for, in the event *all* the shares were not sold within a period of 45 days, it was contemplated that all funds received for shares would be returned to the prospective purchasers without interest, and there would be no further obligation as between underwriter and company. If, however, all of the shares were sold within the 45 days period, then Armstrong was required to pay over $230,000 to Triangle and $70,000 was to be turned over to the underwriter to pay it a commission of 15% (equal to $45,000) with the remaining $25,000 being used to cover all expenses including accounting and legal fees of the company and the underwriter.

The Triangle issue was not entirely sold at the end of October. While there is uncertainty in the figures, the uncertainty does not affect the conclusions that at least 30,000 shares of stock were sold to customers of Armstrong other than brokerdealers, and that upwards of $40,000 was received for those shares and was "held" until it was turned over to Triangle either at the closing—hereafter referred to—on November 16, 1961, or in the days immediately preceding that closing. In addition, at least 70,650 shares had been sold to brokerdealers and had not been paid for by those brokerdealers. In addition to sales of over 100,000 shares just described, it is possible that there were additional brokerdealer sales to the extent of $42,000, payments for which were made and which payments formed a part of the consideration paid over to Triangle at the closing on November 16, 1961. It is also possible that the $42,000 so turned over represented entirely or in some part a portion of the net sum of $123,205 that was allegedly due

from the brokerdealers in respect of their purchases of the 70,650 shares referred to above.

At the end of October the representatives of Triangle began to press Armstrong and Schwartz for a conclusion of the issue; it appears that Edens and Schwartz took the position that all the shares had been sold and that in consequence the issue was ready for closing, subject to getting stock certificates printed, etc. With considerable difficulty an arrangement was made for a November 15, 1961 closing. Armstrong did not have funds to complete the transactions. It needed $230,000, and, while it evidently was ready to turn over at least $40,000 representing some or all of the customers' money Armstrong had received and held on account of customers' orders for the stock, it did not have access to the brokerdealers' money in the amount of $123,205, nor had it yet sold the balance of the issue. In these circumstances the hypothecation transaction with Sterling Factors was arranged, principally through the activity of defendant Schwartz.

An approach was first made to Meadowbrook to determine whether or not it would be prepared to make a delivery of the stock against the brokerdealers' payments, but the bank pointed out that, since the underwriting was an "all or nothing" underwriting, Armstrong was not entitled to have any of the Triangle stock issued either to it or on its order unless and until it could pay for all of the stock. Possibly it was suggested to Meadowbrook that it might advance enough money to Armstrong to enable it to complete the transaction, but if so, Meadowbrook was unwilling so to act. However, out of discussions with Meadowbrook and possibly in connection with turning to another lender, there emerged the idea of having the entire 150,000 shares of stock issued in the name of Armco, the nominee

firm of Armstrong. That suggestion, which implied that the entire issue would then be transferred by Armstrong to someone, would necessitate cancelling a November 10, 1961 letter by which Armstrong had requested Meadowbrook to issue the stock in the names of its individual customers (to the extent, apparently, of 57,650 shares) and in the name of Armco (to the extent, apparently, of 80,700 shares—leaving an unexplained difference of some 11,650 shares), and by directing Meadowbrook to issue all 150,000 shares in the name of Armco in 600 certificates of 1,000 and 100 share denominations. Meadowbrook Bank indicated to defendant Schwartz that it would be prepared to see the stock issued in part against funds borrowed from another source for the purpose of closing out the issue.

Defendant Schwartz then discussed the matter with Edens, and, encouraged by Edens to expect that the brokerdealer payments would be received within a very few days —as soon as the stock certificates were available for delivery to them or in a matter of a week or two at most—he suggested that a loan be obtained from Sterling Factors Corporation. It is not clear that before approaching Sterling Factors the defendant Schwartz and Edens had decided to pledge the entire issue; the earliest thinking emphasized that the payments to become due from the brokerdealers would be the primary security for the loan. In any case an approach was made to Sterling Factors and agreement in principle reached on a loan of $115,000 using the entire 150,000 shares of stock as security.

The working out of the precise terms of the loan transaction took place primarily between defendant Schwartz and Melvin Slade who acted as counsel for Sterling Factors. By the time of the final negotiation it was of the very essence and structure of the proposed borrowing that all

150,000 shares would be pledged as security. Nonetheless, Sterling Factors looked to the brokerdealer payments for prompt liquidation of the loan, and Slade had in mind that the pledge of the entire issue was a means of assuring that the brokerdealers could not get from Armstrong direct delivery to them of free Triangle stock against payment to Armstrong.

After the terms of the proposed loan had been cleared orally by telephone between Schwartz and Slade, defendant Schwartz sent a draft agreement to Slade, but Slade drafted his own papers, quite possibly taking ideas and even some language from the papers prepared by defendant Schwartz. The papers were:

(1) a loan agreement under which Sterling agreed to lend to Armstrong $115,000 to be evidenced by a collateral note payable in four consecutive weekly instalments commencing November 22, 1961, of $25,000 each, the last instalment to be in the amount of $40,000 without interest; Sterling was, at the request and on behalf of Armstrong, to issue its certified check directly to Triangle Instruments Co., Inc., at Meadowbrook and at the same time Armstrong was to deliver a certified check of $3,000 to Sterling to pay the loan fee; Armstrong was to deliver Edens' guarantee of the Armstrong note and certificates for 150,000 shares of Triangle common stock together with stock powers duly endorsed with signature guaranteed for the same number of shares; the shares were spoken of as those recently sold to the public under the Armstrong offering; under the agreement Sterling was to release the shares against repayments of the loan at the rate of $2 a share and was to release all the shares when the entire note had been paid off; the agreement provided that if Armstrong de-

faulted, it would arrange for Sterling to deliver the brokers' shares directly to them; and the agreement provided that as shares were released by Sterling against payments by Armstrong, Armstrong would supply Sterling with a statement of the disposition made of the stock previously released;

(2) an assignment by Armstrong to Sterling of the amounts due from seven brokerdealers, aggregating $123,205, payable in respect of 70,650 shares of Triangle stock; the assignment had annexed to it Armstrong's confirmations of its sales to the brokerdealers;

(3) an instrument addressed by Armco to Sterling by which Armstrong was authorized to pledge the 150,000 shares of Triangle common stock "belonging to the undersigned", meaning Armco (which was not the owner but the street name of Armstrong in which the stock certificates were registered for convenience of transfer upon issue by Meadowbrook);

(4) Armstrong's $115,000 promissory note payable in four weekly instalments, three of $25,000 and the last of $40,000, with the conventional enforcement provisions spelled out at length and reciting the deposit as security for the note of 150,000 shares of Triangle common stock;

(5) subjoined to the note was an "endorsement" by Robert Edens by which he was to guarantee payment of the note;

(6) a form of guaranty of the payment of the note to be signed by Robert Edens;

(7) a letter agreement between Sterling and Armstrong under which Sterling ("the undersigned") agreed to re-

lease pledged Triangle shares at the rate of one share for each $2.00 paid by Armstrong on account of the note; and

(8) a certificate signed by Edens that Armstrong had on November 15, 1961 adopted resolutions authorizing the loan transaction.

In advance of the closing of the loan transaction and the issuance of the stock, under date of November 13, 1961 Armstrong cancelled the letter addressed to Meadowbrook instructing it to issue certificates in the names of sundry customers of Armstrong and in Armco's name and substituted for it an instruction to Meadowbrook to issue all 150,000 shares in the name of Armco, in the form of 500 certificates each of 100 shares and 100 certificates each of 1000 shares. The closing contemplated by the Sterling transaction was to have taken place at November 15th at Meadowbrook Bank. It was visualized that at that time Meadowbrook would have all 600 certificates of stock prepared in the name of Armco for delivery and that 600 stock powers, corresponding to the certificates, would have been signed by Edens for Armco with his signature guaranteed. However, it appears that Armstrong had already paid $40,000 over directly to Triangle on account of Armstrong's customers' purchases of Triangle stock. Apparently the customers had paid more than $40,000 to Armstrong and some of it had been placed in a special or escrow account. However, the only evidence that customers' money was ever paid over to anyone is the evidence that $40,000 of such money was paid to Triangle in advance of the November 15, 16 transactions.

Defendant Schwartz knew before the Sterling loan was consummated that Armstrong had sold stock to customers other than broker-dealers and that the customers had paid Armstrong at the rate of $2.00 a share for a very sub-

stantial number of Triangle shares. Defendant Schwartz also knew before the Sterling loan transaction was consummated that Armstrong was in a position of cash stringency. Defendant Schwartz was not aware, if it was the fact, that Armstrong was insolvent; he assumed, apparently, that Edens' statements to him, that Armstrong had built up a very large position in securities and in consequence had little of its assets in cash, was a truthful explanation. The evidence, however, does indicate that in the period in question from the end of October through November 15, 1961 Armstrong may have been irrecoverably insolvent and may have been misapplying customers' funds and securities. One retrospective calculation drawn from the books of Armstrong, primarily the stock record, tended to indicate that by November 16, 1961 Armstrong had received substantially the cash it needed to close the Triangle transaction if that cash had not been committed or diverted to other uses. The evidence, however, does not establish that defendant Schwartz was aware that the situation had reached that point.

Just before the November 15th closing of the loan and stock issue Edens advised defendant Schwartz that Armstrong could not close the transaction even with the assistance of the $115,000 to be borrowed from Sterling Factors. Nevertheless, the parties assembled on November 15th for the closing at Meadowbrook Bank in the expectation that Triangle would issue all 150,000 shares through Meadowbrook, that Sterling would advance the $115,000 borrowed and that somehow checks could be assembled in an amount sufficient to make up the total of $230,000 and close the transaction. At the closing it turned out that about $30,000 of Armstrong's proffer was not represented by certified checks. Defendant Schwartz offered to give his own check

to cover the balance, but Triangle's lawyer rejected that offer and the closing was adjourned to the following day. Possibly Edens anticipated that Martin Lasher would produce the missing money in good funds in time for the November 15 closing, but perhaps no effort was made to have Lasher produce that amount until after the November 15 closing failed. In any event the closing did take place on November 16 with the help of a check for $33,000 certified by Chemical Bank that represented a Martin Lasher borrowing.

The transaction was closed on November 16, substantially as called for by the Sterling Factors-Armstrong papers with one significant difference. Apparently, it was not contemplated by the papers agreed upon between defendant Schwartz and Slade, representing Sterling Factors, that there would be any additional guaranty other than that of Robert Edens. However, at the closing and before it was consummated defendant Robert Schwartz was asked to and did guarantee the payment of Armstrong's $115,000 note to Sterling Factors. At the closing Triangle and Meadowbroak produced the 150,000 shares of stock issued in the name of Armco and the stock powers duly signed by Edens to cover all the shares, and both the stock certificates and the powers were delivered to Sterling against its delivery of its certified check in the amount of $115,000; that check together with checks of Sentinel Securities Planning Corporation for $2,700, of Bernard L. Madoff for $16,000, two checks of First Madison Corp. aggregating $23,300 and the check of Chemical Bank for $33,000 were turned over to Triangle. These checks totalled $190,000 and, taken with the $40,000 earlier paid over by Armstrong directly to Triangle, constituted the whole consideration to

which Triangle was entitled under the underwriting agreement.

At the time of the closing, however, all of the stock had not been sold to the public. The impression was produced that all of the stock had been sold, and the offering circulars were so stamped. The evidence does not establish beyond a reasonable doubt that defendant Schwartz was conscious that some of the new issue stock had not yet been sold and was, therefore, becoming the property of Armstrong subject to the pledge to Sterling Factors.

The mechanics of the closing are not totally revealed by the evidence but the evidence does show that defendant Schwartz supervised the closing so far as Armstrong was concerned and supervised the transfer of the checks. Among the checks were checks of certain brokerdealers whose accounts payable to Armstrong were supposedly being assigned as unpaid accounts as further security or as the basic security, along with the Triangle stock, for the loan. If it be assumed that the checks of the brokerdealers Sentinel, Madoff, and First Madison delivered at the closing formed a part of the accounts that were being pledged at the closing, the closing becomes difficult to credit. The First Madison Corp. checks exactly correspond in amount to the First Madison account payable allegedly being assigned, and the Sentinel check very closely approximates the whole amount of the Sentinel account payable supposedly being assigned as an unpaid account. Possibly the fact was, or was represented as being, that the brokerdealer checks turned over at the closing represented wholly additional amounts so that, so far as defendant Schwartz is concerned, the checks turned over at the closing did not represent a departure from what was expected. The alternative explanation would be that the fact that $42,000 in

brokerdealer money had already come in was not regarded as jeopardizing the liability of the loan transaction since the whole issue was still being pledged to Triangle and would be under its control until the whole debt was paid.

What happened later and what was later learned by defendant Schwartz has no direct bearing on the ultimate issue on Count 18 so far as it concerns the defendant Schwartz. The transaction did not work out as planned; Armstrong was in default on the payment to Sterling Factors very quickly, and Sterling Factors did not release more than 38,000 shares against payments received from Armstrong. When the transaction was finally liquidated in February of 1962, it was done only by having Armstrong return 25,000 shares of unsold Triangle stock to Triangle, and Triangle thereupon issued its check for $35,000 to Sterling Factors to get release of the remaining 112,000 shares so that they could be distributed to the purchasers (customers and brokerdealers) who had already paid for their stock. Of the entire issue of 150,000 shares it appears, then, that 25,000 shares were returned to Triangle, 38,000 shares released by Sterling before February were presumably distributed to purchasers, 69,200 shares were scheduled for delivery to named customers of Armstrong and of Bernard Madoff and the remaining 17,800 shares were reserved for a few days for delivery to purchasers to be named by Armstrong on or before February 13, failing which such shares were to be restored to Triangle. The aggregate of these various amounts is 150,000 shares of stock.

Defendant Schwartz knew of the existence and terms of the regulation in question, 17 C.F.R. § 240.8c-1. Defendant Schwartz knew also that Armstrong had received substantial sums of money equal to $2.00 a share for the new issue

Triangle shares. On the evidence he is entitled to the inference that he assumed that if Armstrong was unable to liquidate the Sterling loan, none of the customers who had paid amounts equal to $2.00 a share would be able to point to specific shares registered in their names or definitely allocable to their individual payments. It was, however, self-evident, and defendant Schwartz knew, that if for any reason the transaction failed, the customers who had paid $2.00 a share to Armstrong in expectation of receiving Triangle stock would have to look to the general credit of Armstrong for repayment of their money and could not hope to obtain the stock from Sterling unless they could show that Sterling was not in the position of an innocent purchaser for value.

The government has failed to show beyond reasonable doubt that defendant Schwartz believed or knew that the transaction with Sterling Factors was a violation of Section 250.8c-1 of the Regulations. The evidence does not establish that defendant Schwartz specifically discussed the particular transaction with a representative of the New York office of the Securities and Exchange Commission and received from him an opinion, shown to have been based on a complete disclosure of the relevant facts known to the defendant Schwartz and understood and intelligently adverted to by the representative of the Securities and Exchange Commission, that the transaction did not violate the Rule. If such an expression of opinion had been given in the informal circumstances indicated by defendant Schwartz' testimony, he would not have been justified in relying upon it. The fact that defendant Schwartz has an uncertain recollection of such an interview implies unmistakably that at the time in question he was at minimum apprehensive that the transaction violated the regulation.

It is found that defendant Schwartz did not proceed in good faith reliance upon a belief derived from an interview with a responsible representative of the Securities and Exchange Commission that the transaction with Sterling Factors was in conformity with and not violative of the hypothecation regulation.

It was self-evident, and defendant Schwartz is found to have been aware, that the hypothecation of the 150,000 shares of stock to Sterling Factors exposed the customers of Armstrong, who had paid $2.00 a share in the expectation of receiving Triangle stock when it issued, to the risk that they would not receive the stock if Armstrong defaulted on the loan to Sterling and would have to rely on the general credit of Armstrong for the return of their money in that event. It was self-evident, and defendant Schwartz is found to have known, that as to a substantial number of shares of stock of Triangle there was no indebtedness from any customer of Armstrong to it with respect to the Triangle stock.

The issuance of the 150,000 shares of stock by Triangle-Meadowbrook in the name of Armco vested ownership of the stock in Armstrong. Armstrong hypothecated the stock to Sterling as its own stock although that stock, to the exent that Armstrong's customers had already paid for it, was received by Armstrong for the account of such customers, and, whether or not appropriated to those customers, had already been sold to such customers, and it had been paid for by them; such stock represented stock owned, however briefly, by Armstrong and delivered, however fleetingly, to Armstrong; the stock therefore constituted securities carried for the account of the customers. *Cf. People* v. *Atwater,* 229 N.Y. 303 (1920).

Since it must be concluded on the law and on these facts that the stock was in part carried for account of Armstrong customers who had paid in full for the stock, it is concluded that there was a specific violation of the hypothecation rule by the pledge of the entire issue to Sterling. On the facts it is found that defendant Schwartz was a conscious and active participant in the effectuation of the transaction, and that it was in violation of the Rule.

Section 32(a) of the '34 Act (15 U.S.C. § 78ff(a)) requires proof of wilful violation, and the last clause of the subsection makes it clear that conviction, but not a sentence of imprisonment, may take place even where the defendant did not know of the rule or regulation upon the transgression of which his conviction is based. The decisive inference from this is that an actor "wilfully violates" if he consciously and purposefully performs (or, as in defendant Schwartz' case, intentionally participates in performing) the acts which objectively make up the violation. Does the statute require in addition that the defendant be conscious that the conduct is wrongful in a sense relevant to the context of the regulation violated? Again the structure of Section 32 indicates that the purposeful doing of the acts which, objectively, constitute violation of the regulation suffice to constitute wilful violation of Section 32. That Section punishes (1) any person who "wilfully violates" any regulation the violation of which is made unlawful by the Act (as Section 8(c) does here) by fine, and (2) by imprisonment if the person knows of the regulation; and (3) any person who "wilfully and knowingly" makes false or misleading filings under Section 15(d); and Section 32 (c) altogether excludes from the operation of subsection (a) cases of violation of regulations under Section 15(c)(3) (relating to financial responsibility of brokers and dealers)

other than cases of false and misleading filings. The statute by so distinguishing among kinds of regulations, and by requiring wilful and knowing falsification of filings (whether or not the applicable regulation is known to the offender) to make out a criminal offense makes it plain that the remaining punishable wilful violations do not require a specific intention to transgress a Regulation known to exist and understood to be applicable. *Cf. United States* v. *Simon,* 2d Cir. 1969, 425 F.2d 796, 809; *United States* v. *Crosby,* 2d Cir. 1961, 294 F.2d 928, 942; *United States* v. *Mandel,* S.D.N.Y. 1969, 296 F.Supp. 1038; *United States* v. *Lilley,* S.D. Tex. 1968, 291 F.Supp. 989, 992. Here the conduct involved was not by any means free of the taint of manifestly unfair dealing and it is difficult to visualize a case under 17 C.F.R. § 240.8c-1(a)(3) which would not have marked characteristics of improper dealing. *Cf. Morisette* v. *United States,* 1952, 342 U.S. 246, 252-262, particularly 254-256. *Contrast United States* v. *Murdock,* 1933, 290 U.S. 389, 396.

GENERAL FINDING

Defendant is guilty as charged by Count 18.

Dated: Brooklyn, New York
April 1971.

.....

U. S. D. J.

Memorandum and Order

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF NEW YORK

66 CR 425

UNITED STATES OF AMERICA,

—against—

ROBERT SCHWARTZ,

Defendant.

DOOLING, *D.J.*

1. Defendant argues that a violation under § 8(c) of the Securities Exchange Act of 1934, 15 U.S.C. § 78h(c) has not been shown because Armstrong could not on the facts as found be held to be a "broker or dealer who transacts a business in securities through the medium of any" member of a National Securities Exchange. The facts were indeed carefully found to make explicit the very part which defendant assails as fatal to the jurisdiction. Defendant emphasizes that "there are two sections of a statute covering an identical violation," with one section covering the conducting of business in over-the-counter securities and the other conducting a business in listed securities as or through a member of a National Securities Exchange; that, therefore, where more than 99% of a firm's business was transacted over-the-counter and less than 1% was listed, it was obligatory upon the Government to indict under the section applying to the nine-nine percent rather than the section applying to the less than one percent transactions. The thought is that § 15(c)(3) of the '34 Act, 15 U.S.C. § 78o(c)(3) could have been the base of the prosecution and it was voluntarily eschewed.

Count 18 does not allege that Armstrong made use of the mails or any means or instrumentality of interstate commerce to effect, induct or attempt to induce a transaction in securities over the counter in contravention of the hypothecation rule adopted under § 15(c)(3). Rather, it proceeds on § 8(c). The count does refer to § 15, as well as to § 8, but it lacks the necessary jurisdictional allegations to support a § 15 charge. It does explicitly allege the jurisdictional element from § 8.

Reconsideration of the present point, raised at the very beginning of the trial by the defendant, and insisted upon throughout, draws attention, at long last, to the fact that there could not apparently have been an indictment under § 15. If there was to be any indictment for a criminal violation of the hypothecation rule it had to be under § 8.

Section 8(c) is an explicit hypothecation section which applies to member firms of National Securities Exchanges and to brokers and dealers who transact a business in securities through the medium of any member directly or indirectly (even though they are not themselves member firms but presumably are over-the-counter firms or limited-role firms of some other sort). Section 8 is a section which deals with the securities dealers' borrowings, indebtednesses to all persons, including customers, and hypothecations, and it deals with nothing else. Section 15 on the other hand deals with transactions which are not conducted on national security exchanges but over-the-counter, and it deals further with the registration of brokers and dealers to conduct such transactions quite without reference to whether those brokers or dealers are also members of one or more of the National Securities Exchanges. Broadly the section forbids brokers or dealers from conducting over-the-counter transactions unless they are registered under § 15 and

provides the details respecting their registration. Then Subsection (c) of § 15 prohibits dealers and brokers from using the mails and instrumentalities of commerce to effect transactions in securities over the counter (1) by means of any manipulative, deceptive or other fraudulent devices or contrivances, (2) in connection with which such broker or dealer engages in any fraudulent, deceptive or manipulative act or practice, or makes any fictitious quotation and (3) in contravention of rules and regulations prescribed by the Commission for the protection of investors to provide safeguards with respect to the financial responsibility of brokers and dealers.

The hypothecation regulation adopted under § 15(c)(3), while it uses practically identical language to that used in the hypothecation regulation under § 8(c), does not implement such specific language as that of § 8(c), which deals directly with hypothecation, but is adopted under the broadly generalized language of § 15(c) which establishes a power in the Commission to provide rules and regulations for the protection of investors in respect of the financial responsibility of brokers and dealers.

Section 32, imposing penalties (15 U.S.C. § 78ff) provides in subdivision (c) that the penalty provision shall not apply at all in the case of a violation of a rule or regulation prescribed pursuant to § 15(c)(3); the only exception to that is for regulations or rules adopted under § 15(c)(3) which prescribe filings, and violations of such regulations through false statements or misleading concealments can give rise to penalty proceedings under § 32. Hence count 18 had to be drafted under § 8(c) if it was to charge an offense at all.

Defendant's point therefore is of first importance, and he is quite right in saying that the decision is that the quantum of the business in securities conducted through

the medium of members of National Securities Exchanges has been treated as not important and not decisive. It was not suggested that trivial or *de minimis* transactions would have the indicated consequence, but it was intended to make clear that the decision was not based on any finding or illusion that the quantum of securities business conducted through the medium of member firms was great.

The language introducing § 8 is plainly not the gist of such an offense as arises through a violation of § 8(c) and the regulations under it. It is part of the "jurisdictional" basis of the legislative action. The Securities Acts, when drafted, invoked the commerce clause as providing Congressional authority to legislate, and they were drafted in considerable part in terms of National Securities Exchanges viewed as facilities using the mails and instrumentalities of interstate commerce, as well as in terms of the direct use transactionally of the mails and interstate commerce. The thrust of regulation, however, is not at the elements that afford support for Congressional legislative authority, but it is rather at the conduct of the securities business itself in terms of its substantive dealings, and those substantive regulations are extended to every aspect of the securities business that could fairly be brought within reach of federal legislative competency by reason of a connection with the mails, instrumentalities of interstate commerce, and utilization of national exchanges themselves instrumentalities of trading that largely rested upon interstate transactions. Hence not the quantum of a broker-dealer's transactions directly on National Securities Exchanges or through their members, but the fact of their dealing with such member firms would appear to be the jurisdictionally significant point. The theoretical basis for interpreting § 8(c) as making any dealing with a member firm produce as a consequence subjection to the restrictions

of § 8 would be that such a result was desirable and intended because all brokers and dealers which dealt with one another to any extent should be subject to a common rule respecting such a critical area as borrowings, indebtedness and hypothecation.

Congress of course did not specifically visualize that a regulation under § 15(c)(3) of the '34 Act would be made to embody the substance of § 8(c) any more, probably, than it visualized specifically that a rule under § 10(b) of the '34 Act would invoke language and structure from § 17(a) of the '33 Act. Hence, no doubt visualizing that regulations under § 15(c)(3) would be of considerable complexity and could frequently involve involuntary violations arising out of rapid fluctuations in the values of securities, it relieved violations of the possible future regulations from penal sanction except for such regulations as had to do with filings and their truthfulness.

2. Defendant emphasizes that he has been held guilty notwithstanding that it has not been found that the Government showed beyond a reasonable doubt that the defendant believed that the transaction was a violation of the regulations. He argues further that everyone else involved regarded the transaction as legal. It is not, however, correct to make the argument in that form since the Government was not concerned to show the facts as to anyone else, and it may be inferred in favor of all of them that they had no genuine knowledge of Armstrong's affairs or of the transaction itself. Defendant's guilt is placed on his knowledge of the rule, his conscious and intentional participation in acts which constituted a violation of it, and his necessary perception that what was done subjected the customers who had paid for their stock to precisely

the risk which the rule was intended to protect them from having imposed upon them. That defendant may have believed or hoped that the regulation did not proscribe the precise kind of closing transaction set up with Sterling Factors, did not acquit him of guilt. The general finding thus presupposed that there can be guilt and that in this case there was guilt in the classic sense of *mens rea* even though defendant thought, whether after talking to the representative of the SEC or otherwise, that the transaction did not transgress the letter of the regulation. The transaction was nevertheless, as the *Atwater* case suggests, in fact a violation of a regulation known to exist, and a reprehensible act within its own dimensions independently of the regulation.

3. Defendant points out that the analysis of meaning has been carried out as if the offense with which defendant is charged had been a violation of § 32, a section which deals only with violations of regulations which apply only to brokers, dealers or member firms, whereas defendant is charged as a conspirator under § 371 and § 2 of Title 18. That is very true. The present case was one in which defendant's participtaion in Armstrong's offense involved him in guilt of it not only through the operation of § 2 of Title 18, U.S.C., but also through the inevitable conspiracy to do what was successfully done. But for purposes of determining whether the conspiracy was committed in terms as alleged it was necessary to determine whether what was done in fact, and planned before it was done, did constitute Armstrong's violation of § 32 and defendant's participation in it. The case is not different in principle from *Pinkerton* v. *United States,* 1946, 328 U.S. 640, in this respect.

4. Defendant suggests that the grand jury could not very well be expected to have before it evidence to show the jurisdictional basis of count 18, that is, that Armstrong was conducting a securities business through the medium of member firms of National Securities Exchanges. Subject to what has already been said on an earlier motion in this case about the far-reaching meaning of *Costello*, it may additionally be questioned whether the grand jury is under any duty to investigate and make implicit findings with respect to jurisdiction. That may well be a matter rather to be settled objectively and to be determined in the first instance by the prosecuting authority in determining whether or not to present the case to the grand jury.

However, the minutes do disclose transactions for customers in the stock of Ford Motor Company and Zenith Radio Corporation through Reynolds & Co., a member firm of the New York Stock Exchange and the Commodity Exchange, and the evidence indicated that there was a regular trading connection through Reynolds & Company and specifically through Jack Moore, a manager in that stock exchange firm.

On the basis of the data there was enough before the grand jury to authorize them, if competent evidence was required to that end, to include in count 18 the jurisdictional allegation with respect to conducting a securities business through the medium of a member firm of a National Securities Exchange.

Accordingly, it is

ORDERED that the motion for a judgment of acquittal and for a new trial is in all respects denied.

Brooklyn, New York
May 14, 1971.

JOHN F. DOOLING, JR.
U.S.D.J.

Judgment and Commitment

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF NEW YORK

FILED

in Clerk's Office

U. S. District Court E.D. N.Y.

JUL 30 1971

66 CR-425

UNITED STATES OF AMERICA,

v.

ROBERT SCHWARTZ.

On this 30th day of July, 1971 came the attorney for the government and the defendant appeared in person and with counsel.

IT IS ADJUDGED that the defendant upon a special findings of guilty has been convicted of the offense of violating T-18, U.S.C. Sec. 371, in that on or about and between October 10 and November 15, 1961, both dates being approximate and inclusive, the defendant with others, known and unknown to the Grand Jury, wilfully and knowingly conspired together to commit offenses against and to defraud the U.S., more particularly, the Securities & Exchange Commission, in violation of Sections 78h(c), Title 15, U.S.C. by agreeing to cause a broker and dealer registered with the Securities and Exchange Commission, which transacted business in securities through the medium of member of a national

securities exchange, to pledge and hypothecate 150,0[illegible] shares of the common stock of Triangle Instrument C[illegible] Inc., to Sterling Factors Corp., which shares carried f[illegible] the account of customers of the broker under circu[illegible] stances that permitted the commingling of the custome[illegible] stock without their written consent as charged in count [illegible] and the court having asked the defendant whether he h[illegible] anything to say why judgment should not be pronounce[illegible] and no sufficient cause to the contrary being shown or a[illegible] pearing to the Court,

IT IS ADJUDGED that the defendant is guilty as charg[illegible] and convicted.

IT IS ADJUDGED that the defendant is sentenced on cou[illegible] 18 to pay a fine of $2,500.00. Execution of sentence stay[illegible] pending appeal.

IT IS ORDERED that the Clerk deliver a certified copy o[illegible] this judgment and commitment to the United States Ma[illegible] shal or other qualified officer and that the copy serve a[illegible] the commitment of the defendant.

JOHN F. DOOLING
United States District Judg[illegible]

A TRUE COPY

ATTEST

DATED Oct. 5, 1971

LEWIS ORGUL
Clerk

BY JAMES A. ABRAM
Deputy Clerk